

Zensar Technologies

BSE SENSEX

35,600

S&P CNX

10,808

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Stock Info

Bloomberg	ZENT IN
Equity Shares (m)	45
52-Week Range (INR)	1345 / 730
1, 6, 12 Rel. Per (%)	4/46/29
M.Cap. (INR b)	56.0
M.Cap. (USD b)	0.8
Avg Val, INRm	29.0
Free float (%)	51.1

Financials Snapshot (INR b)

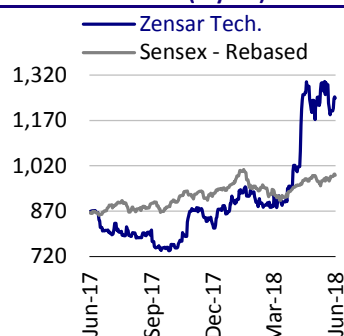
Y/E Mar	2018	2019E	2020E
Net Sales	31.1	37.2	41.9
EBITDA	3.6	5.1	6.1
PAT	2.4	3.4	4.1
EPS (INR)	52.8	76.1	90.9
Gr. (%)	1.3	44.3	19.4
BV/Sh (INR)	365.4	426.6	496.3
RoE (%)	15.3	19.2	19.7
RoCE (%)	18.2	23.3	24.6
P/E (x)	23.6	16.3	13.7
P/BV (x)	3.4	2.9	2.5

Shareholding pattern (%)

As On	Mar-18	Dec-17	Mar-17
Promoter	48.9	48.9	48.6
DII	11.7	11.4	2
FII	6.1	6.1	14.6
Others	33.3	33.6	34.8

FII Includes depository receipts

Stock Performance (1-year)


CMP: INR1,248 TP: INR1,450(+15%)
Buy

Ready to grow the core; improve profitability

We attended the RPG Group analyst meet. In this note, we present the key highlights of our meeting with Zensar Technologies (ZENT):

As Digital scales up, profitability should follow suit

- **Approach to Digital reaping dividends....:** Digital has been growing at more than 30% and now contributes 41% of ZENT's total revenue. More than 80% of the business has been home-grown; the company will continue developing new solutions to further strengthen this segment.
- **...Marked by 'Return on Digital' proposition:** ZENT's Return on Digital (ROD) framework is now part of every deal, with everything being native digital, mobile and cloud. The suite has various platforms that are made for distinct functions, for instance – CMOs can use the relevant solution to measure campaign effectiveness, CIOs can run the entire IT on this platform, and the sales function can track real-time movement of pipeline, closures and revenue.
- **Profitability in Digital should follow with scale:** Although ZENT's Digital margins are equivalent to company average, there is scope for further improvement as the business scales up. Deals, though, have been increasing – at USD8-12m now v/s USD1-3m two years ago.

Portfolio pivot nearly complete; multiple margin levers in hand

- **Lesser non-core to deal with in FY19:** While Digital is fast-growing for ZENT, legacy has been under pressure, especially in non-core IMS. However, the company is at the bottom in IMS and should start seeing growth. In the top client, too, the market share has been increasing. The negative for FY19 should be the impact from bankruptcy of a large Retail client.
- **Restructuring progress:** Restructuring in a couple of areas has taken longer than anticipated: (i) US sales – a team is now in place, but sales are yet to take off meaningfully; have won 3-4 large deals in the US in the recent past and (ii) Cloud infrastructure – restructuring should have been through 3-4 quarter ago.
- **Multiple margin levers:** Margins were impacted last year by client-related write-offs and non-core businesses (MVS and RoW). However, an improvement going forward should be led by (i) scale in Digital, (ii) absence of one-off expenses, (iii) pyramid rationalization (1,000 fresher additions this year), (iv) higher revenues from platforms / solutions and (v) growth in the cloud infrastructure business and higher proportion of as-a-service revenue.

Valuation and view

Over FY18-20, we expect revenue CAGR of 13% and significantly better earnings CAGR of 31%, which comes from 270bp cumulative margin improvement. With improvements visible, we see ZENT's multiple gradually converging with its peer-set, which trades at 18-20x. Embedding some caution, our price target of INR1,450 discounts forward earnings by 16x, until numbers truly start reflecting the underlying qualitative improvement. Maintain **Buy**.

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Valuation and view

- **Execution for next leg of growth is in progress:** Post the leadership change at ZENT, execution has been fast-tracked, with several steps taken toward realigning the organization with its growth engines. In line with this, several services/solutions have been launched, sales function has been augmented and there is a renewed focus on client mining and large deals. These initiatives are currently in the investment mode and likely to start adding to growth along with Digital and IMS.
- **Digital – the key trigger:** Digital accounts for 38% of ZENT's revenue and has been growing at 35% YoY. Over the last year, it has built several solutions: [1] The Vinci – a cloud orchestration and managed services platform, [2] ZenAnalytica – predictive analytics, [3] SmartBlox – blockchain feasibility assessment, [4] RPA – using bots to automate processes and [5] Digital Workplace Services. Although deal sizes are currently smaller, nearly 50% of ZENT's wins lately have been in Digital. It has further augmented its presence in Digital with the addition of Foolproof and Keystone, adding capabilities across user experience and supply chain solutions.
- **Aggressive consolidation of non-core business:** Over the last two years, ZENT has cut out non-core geographies, verticals and service lines. Since the leadership change, the company has renewed its focus on strategic accounts, and is in the process of cutting its long tail of low-yield and non-scalable accounts. Pruning of these accounts has been ongoing for the last six quarters, and has fairly bettered the business mix.
- **Expect rebound in revenue growth:** On account of ongoing restructuring, the company clocked 5% revenue growth in FY18 (including 2.5% from the integration of Keystone). However, with the implementation of growth engines well on track and a clean base to work on, we expect a revival in revenue growth to 13% over FY18-20 (includes Cynosure).
- **Margin comfort for FY18-20:** Over FY18-20, we expect revenue CAGR of 13% and significantly better earnings CAGR of 31%, which comes from 270bp cumulative margin improvement. With improvements visible, we see ZENT's multiple gradually converging with its peer-set, which trades at 18-20x. Embedding some caution, our price target of INR1,450 discounts forward earnings by 16x, until numbers truly start reflecting the underlying qualitative improvement. Maintain **Buy**.

Key triggers

- Broad-based pick-up in revenue growth
- Margin improvement despite investments
- Significant increase in deal wins and deal pipeline

Key risk factors

- Problems in top accounts
- Risk from slower spend on ERP
- Hindrances in structural recovery of margins

Exhibit 1: 1-year forward P/E band

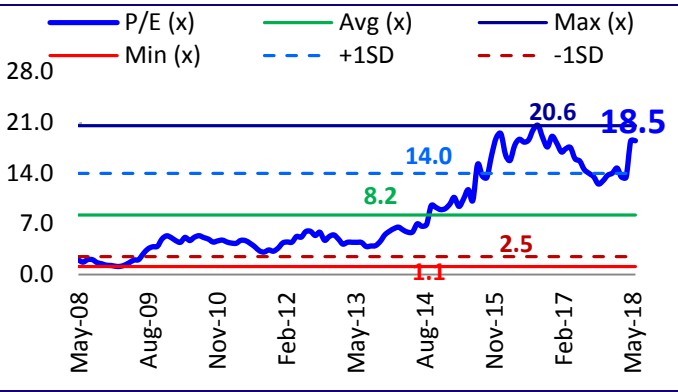
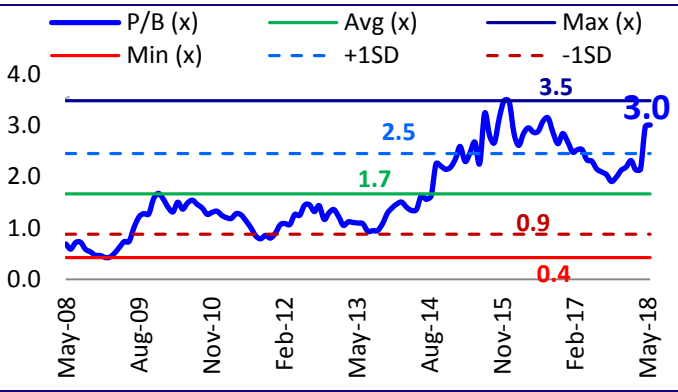
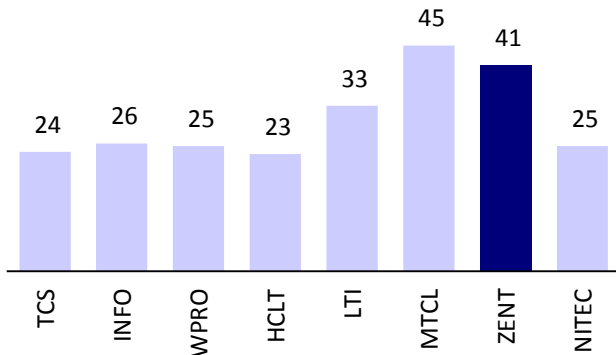


Exhibit 2: 1-year forward P/B band



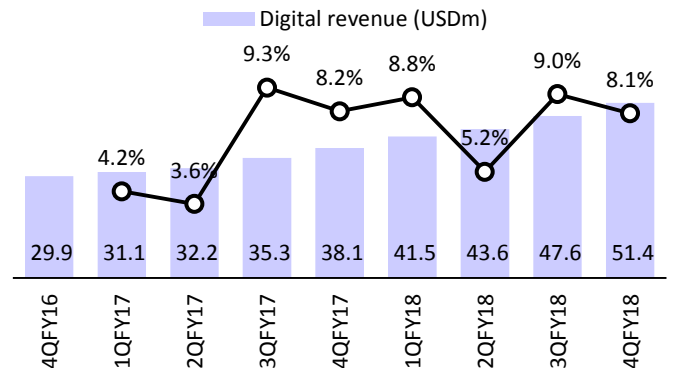
Story in charts

Exhibit 3: Contribution of Digital to total revenue among the highest in the industry



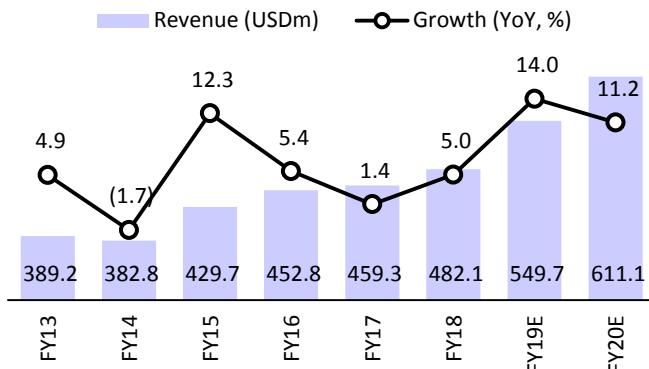
Source: MOSL, Company

Exhibit 4: Strong traction seen in Digital



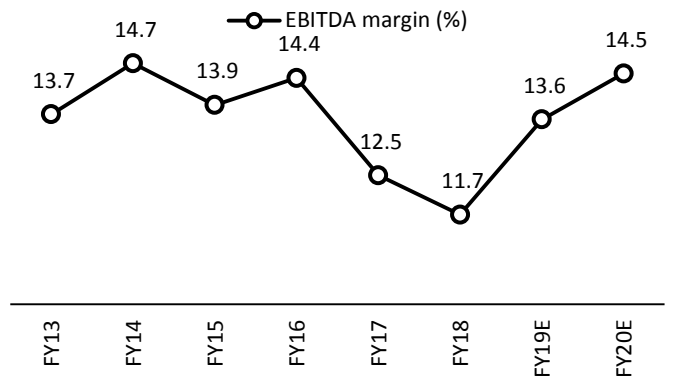
Source: MOSL, Company

Exhibit 5: Expect revenue growth to pick up



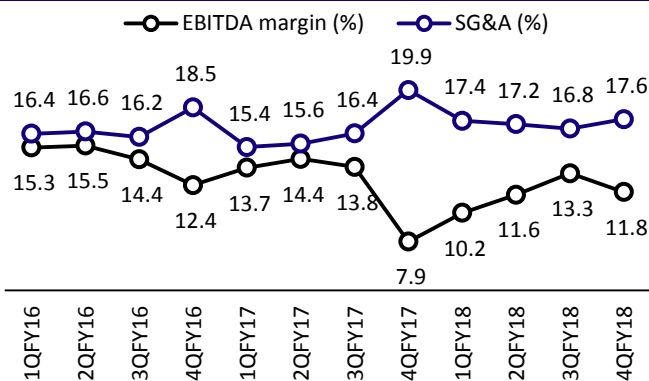
Source: MOSL, Company

Exhibit 6: ...coupled with margin expansion...



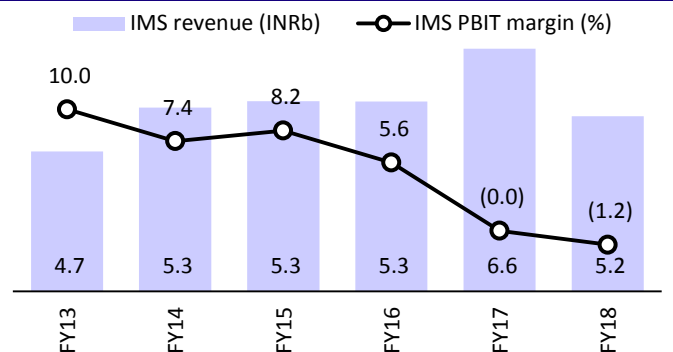
Source: MOSL, Company

Exhibit 7: ...assisted by coming off of investments...



Source: MOSL, Company

Exhibit 8: ...and potential for improvement in IMS margins



Source: MOSL, Company

Operating metrics

Exhibit 9: Operating metrics

	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Geographic Mix (%)									
USA	78	75	75	74	74	74	72	73	72
Europe	10	11	10	12	14	14	14	14	14
ROW	12	15	15	14	13	12	14	13	14
Vertical Mix (%)									
Manufacturing	54	54	52	52	53	49	49	49	50
Retail and consumer services	24	24	26	25	26	28	29	29	29
Financial services	18	18	18	19	17	19	19	20	20
Emerging	4	4	5	4	3	4	3	3	2
Service Mix (%)									
Application Management Services	77	77	77	76	81	82	83	83	86
Infrastructure Management Services	23	23	23	24	19	19	17	17	14
Maintenance	8	8	7	7	7	6	6	5	5
Services	16	15	16	17	11	12	11	12	9
Project Type (%)									
Fixed price	53	50	50	47	47	48	51	53	54
Time & material	47	50	50	53	53	52	49	47	46
Revenue by delivery (%)									
Onsite	64	69	66	67	66	63	63	63	63
Offshore	36	31	34	33	35	38	38	37	37
Client metrics									
Client concentration (%)									
Top 5	38	37	39	37	38	35	35	36	39
Top 6-10	8	9	10	8	8	8	8	9	9
Top 10	46	46	49	45	46	43	44	45	48
Top 11-20	10	10	11	11	10	11	13	11	12
Top 20	56	56	59	56	56	55	56	56	59
Client brackets									
1 Million dollar +	66	65	69	71	72	74	70	66	63
5 Million dollar +	5	6	6	6	7	7	8	9	13
10 Million dollar +	4	4	4	4	4	4	4	4	2
20 Million dollar +	2	2	2	2	3	2	2	2	2
Other metrics									
Repeat business (%)	85	77	79	75	75	76	82	80	87
Number of active clients	194	183	187	215	216	243	248	260	253
New clients added in the period	18	21	16	41	11	44	29	12	28
Employee metrics									
Total headcount	8,256	8,238	8,316	8,564	8,524	8,567	8,414	8,597	8,905
Gross employees added during the period	588	662	730	750	573	606	419	684	900
Net employees added during the period	64	(18)	78	248	(40)	43	(153)	183	308
Utilization	81	80	80	80	79	83	86	85	84
Attrition	16	18	16	16	15	15	15	15	15

Source: Company, MOSL

Financials and Valuations

Key assumption

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
INR/USD Rate	54.3	60.5	61.1	65.5	66.5	64.5	67.8	68.6
Revenues (USD m)	389.2	382.8	429.7	452.8	459.3	482.1	549.7	611.1
Offshore Revenue (%)	30.0	32.3	33.3	35.5	33.2	37.3	35.8	35.3
Total Headcount	6,508	6,791	8,174	8,256	8,524	8,905	9,825	10,425
Net Addition	(613)	283	1,383	82	268	381	920	600
Per Capita Productivity (USD)	59,805	56,364	52,574	54,850	53,883	54,138	55,945	58,615

Income Statement

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Net Sales	21,145	23,156	26,277	29,643	30,556	31,077	37,244	41,939
Change (%)	18.6	9.5	13.5	12.8	3.1	1.7	19.8	12.6
EBITDA	2,892	3,396	3,641	4,262	3,819	3,647	5,056	6,067
EBITDA Margin (%)	13.7	14.7	13.9	14.4	12.5	11.7	13.6	14.5
Depreciation	332	383	415	454	486	651	708	734
EBIT	2,561	3,013	3,226	3,808	3,333	2,996	4,349	5,333
Interest	100	109	112	106	88	228	202	173
Other Income	145	495	545	588	241	714	684	595
Extraordinary items	0	0	0	0	0	0	0	0
PBT	2,606	3,399	3,659	4,289	3,487	3,482	4,830	5,755
Tax	861	1,023	1,013	1,169	1,103	1,052	1,353	1,612
Tax Rate (%)	33.0	30.1	27.7	27.3	31.6	30.2	28.0	28.0
Min. Int. & Assoc. Share	0	0	1	26	35	50	44	44
Reported PAT	1,745	2,375	2,646	3,094	2,349	2,380	3,434	4,100
Adjusted PAT	1,745	2,375	2,646	3,094	2,349	2,380	3,434	4,100
Change (%)	10.0	36.1	11.4	17.0	-24.1	1.3	44.3	19.4

Balance Sheet

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Share Capital	436	438	443	446	449	449	449	449
Reserves	6,853	9,017	11,127	12,205	14,256	16,039	18,799	21,943
Net Worth	7,289	9,455	11,570	12,651	14,705	16,487	19,248	22,392
Debt	2,353	2,032	1,396	1,967	2,049	2,799	2,549	2,299
Deferred Tax	0	0	0	0	0	0	0	0
Total Capital Employed	9,642	11,498	12,977	14,658	16,828	19,360	21,871	24,765
Gross Fixed Assets	6,341	6,503	8,201	1,884	2,490	2,940	3,390	3,840
Less: Acc Depreciation	2,372	2,287	2,728	710	1,175	1,826	2,534	3,267
Net Fixed Assets	3,969	4,215	5,474	1,174	1,315	1,114	856	573
Capital WIP	25	21	14	2	10	10	10	10
Investments	417	1,478	931	1,078	1,467	1,567	1,667	1,767
Current Assets	8,162	9,145	10,926	16,435	18,235	21,923	25,449	29,193
Inventory	1,049	1,288	1,226	1,259	1,127	1,146	1,373	1,546
Debtors	3,354	3,581	4,539	5,400	5,327	5,417	6,493	7,311
Cash & Bank	1,420	1,458	1,960	2,769	3,291	4,441	6,098	8,406
Loans & Adv, Others	2,339	2,818	3,201	7,007	8,491	10,918	11,485	11,929
Curr Liabs & Provns	2,931	3,361	4,368	4,032	4,199	5,252	6,112	6,778
Curr. Liabilities	2,615	2,893	3,731	4,010	4,199	5,252	6,112	6,778
Provisions	315	468	637	22	0	0	0	0
Net Current Assets	5,231	5,784	6,558	12,403	14,036	16,670	19,336	22,415
Total Assets	9,642	11,498	12,977	14,658	16,828	19,361	21,870	24,764

Financials and Valuations

Ratios

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Basic (INR)								
EPS	40.2	54.7	61.0	68.2	52.1	52.8	76.1	90.9
Cash EPS	47.8	63.6	70.5	78.2	62.8	67.2	91.8	107.1
Book Value	167.9	217.9	266.6	278.9	325.9	365.4	426.6	496.3
DPS	8.0	10.1	11.2	12.0	12.0	11.3	12.8	18.1
Payout (incl. Div. Tax.)	20.0	18.4	18.4	17.6	23.0	21.5	16.8	19.9
Valuation(x)								
P/E	0.0	22.7	20.4	18.2	23.9	23.6	16.3	13.7
Price / Book Value	0.0	5.7	4.7	4.5	3.8	3.4	2.9	2.5
EV/Sales	0.0	2.3	2.0	1.8	1.7	1.7	1.3	1.1
EV/EBITDA	0.0	15.5	14.3	12.7	13.8	14.3	9.9	7.8
Dividend Yield (%)	0.0	0.8	0.9	1.0	1.0	0.9	1.0	1.5
Profitability Ratios (%)								
RoE	26.7	28.4	25.2	25.6	17.2	15.3	19.2	19.7
RoCE	30.3	30.8	28.6	30.2	23.2	18.2	23.3	24.6
RoIC	24.4	25.8	25.1	26.5	19.9	16.5	22.8	26.8
Turnover Ratios (%)								
Debtors (No. of Days)	74	78	86	95	94	94	94	94
Inventory (No. of Days)	26	29	24	23	19	19	19	19
Creditors (No. of Days)	26	34	26	33	35	43	42	42
Leverage Ratios (%)								
Net Debt/Equity (x)	0.1	0.1	0.0	-0.1	-0.1	-0.1	-0.2	-0.3

Cash Flow Statement

(INR Million)

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Adjusted EBITDA	2,892	3,396	3,641	4,262	3,819	3,647	5,056	6,067
Non cash opr. exp (inc)	70	375	171	589	559	664	640	551
(Inc)/Dec in Wkg. Cap.	-1,152	-625	382	-1,218	-281	850	-1,008	-655
Tax Paid	-750	-1,051	-988	-1,046	-1,024	-1,052	-1,353	-1,612
Other operating activities	0	0	0	0	0	0	0	0
CF from Op. Activity	1,060	2,094	3,206	2,587	3,073	4,109	3,336	4,352
(Inc)/Dec in FA & CWIP	-334	-323	-372	-423	-349	-450	-450	-450
Free cash flows	726	1,771	2,834	2,164	2,724	3,659	2,886	3,902
(Pur)/Sale of Invt	87	-961	-1,448	1	-1,538	-2,434	-104	-104
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	-247	-1,284	-1,819	-422	-1,887	-2,884	-554	-554
Inc/(Dec) in Net Worth	16	59	62	42	46	0	0	0
Inc / (Dec) in Debt	-124	-120	-124	-109	-88	-228	-202	-173
Interest Paid	-651	-302	-271	-266	-198	750	-250	-250
Divd Paid (incl Tax) & Others	-371	-401	-542	-1,023	-424	-598	-674	-1,066
CF from Fin. Activity	-1,131	-764	-874	-1,356	-664	-76	-1,125	-1,489
Inc/(Dec) in Cash	-318	46	512	809	522	1,149	1,656	2,309
Add: Opening Balance	1,739	1,413	1,448	1,960	2,769	3,292	4,441	6,098
Closing Balance	1,420	1,458	1,960	2,769	3,291	4,441	6,098	8,406

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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Analyst ownership of the stock

Zensar Technologies

No

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